

# *Fordham Journal of Corporate & Financial Law*

---

*Volume 15, Number 3*

2009

*Article 4*

---

## Stretching the Limits of Deal Protection Devices: From Omnicare To Wachovia

Eleonora Gerasimchuk\*

\*

Copyright ©2009 by the authors. *Fordham Journal of Corporate & Financial Law* is produced by The Berkeley Electronic Press (bepress). <http://ir.lawnet.fordham.edu/jcfl>

# STRETCHING THE LIMITS OF DEAL PROTECTION DEVICES: FROM *OMNICARE* TO *WACHOVIA*

*Eleonora Gerasimchuk\**

While I don't suggest that you rip the Omnicare pages out of your notebook . . . . I do suggest that there's the possibility, one could argue, that the decision has the life expectancy of a fruit fly.

– Justice Steele<sup>1</sup>

[I]t's really not my place to note this, but Omnicare is of questionable continued vitality.

– Vice Chancellor Lamb in  
*Optima International of Miami, Inc. v. WCI Steel, Inc.*<sup>2</sup>

## INTRODUCTION

J.P. Morgan's government-supported acquisition of Bear Stearns and Wells Fargo's acquisition of Wachovia stretched<sup>3</sup> the limits of deal

---

\* LL.M. in Banking, Corporate and Finance Law, Fordham University School of Law, 2009; Dr. iur., University of Hamburg, 2005; Diploma in law, Lomonosov Moscow State University, 2002. I thank Professor Richard Squire and Professor Sean Griffith, who taught me corporate law at Fordham.

1. See David Marcus, *Man of Steele*, D&O ADVISOR, Sept. 2004, at 16.

2. Transcript of Oral Argument at 127, *Optima Int'l of Miami, Inc. v. WCI Steel, Inc.*, C.A. No. 3833-VCL (Del. Ch. June 27, 2008), available at [http://lawprofessors.typepad.com/mergers/files/\\_0702120713\\_001.pdf](http://lawprofessors.typepad.com/mergers/files/_0702120713_001.pdf) [hereinafter *Optima Transcript*]. There is no opinion in this case. Due to the time-sensitive nature of the proceeding, Vice Chancellor Lamb ruled from the bench.

3. Professor Steven M. Davidoff wrote the following in his posting to The Harvard Corporate Governance Blog:

From Bear to AIG to Wachovia, dealmakers have been pushing and testing the limits of deal protection devices to lock-up these government sponsored deals safe in the assumption that Delaware is unlikely to intervene . . . . [I]t remains to be seen how this stretching will affect how deals are done outside the government sphere, and how Delaware's jurisprudence will respond to the use of more circumscribing lock-ups in ordinary course deals. For those who subscribe to the theory that Delaware's jurisprudence is a thaumatrope—oscillating between strictness and laxity depending upon the times—Delaware is likely to tolerate these lock-ups for the time being as

protection devices as articulated by the Delaware Supreme Court in *Omnicare v. NCS Healthcare*.<sup>4</sup> In *Omnicare*, Delaware's highest court held that, where the deal protection devices make an alternative deal a "*fait accompli*,"<sup>5</sup> they are invalid under the *Unocal*<sup>6</sup> standard. These developments in deals struck amidst the financial crisis support the continuing tendency to reject the *Omnicare* ruling more broadly. This Essay describes the steps in the process of "[t]he [l]ong, [s]low [d]eath of *Omnicare*"<sup>7</sup> and argues that these are the steps in the right direction.

Part I contains a short overview of different types of deal protection devices used in corporate acquisitions, explains the reasons for their use and puts them into the context of directors' fiduciary duties. Part II describes the limits on deal protection devices as they were set by the *Omnicare* decision. Part III analyzes the decisions of courts in Delaware and other states rendered after *Omnicare*, which have loosened the *Omnicare* restrictions on deal protection devices. Part IV concludes.

## I. DEAL PROTECTION DEVICES IN CORPORATE ACQUISITIONS

The essence of any deal protection device is to lock up a signed deal and allow it to close as planned. A deal protection device should either prevent the target from taking any steps that would encourage another bidder to come forward with a competing offer or shield the signed deal against a negative shareholder vote.<sup>8</sup>

---

necessary to the preservation of our capital markets system. The truth remains to be seen.

Posting of Steven Davidoff to The Harvard Corporate Governance Blog, <http://blogs.law.harvard.edu/corpgov> (Dec. 6, 2008, 12:42 EST). The title of this Essay should be understood in the sense of "loosening the restrictions on deal protection devices" as they were set by the *Omnicare* decision, and not in the sense of further broadening the *Omnicare* holding and applying its restrictions on a wider basis. Since the idea of this Essay originated in Professor Davidoff's commentary, I have decided to retain Professor Davidoff's wording, although the title is somewhat ambiguous.

4. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).

5. *Id.* at 936.

6. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

7. *See* Posting of Professor Davidoff to DealBook Blog, <http://dealbook.blogs.nytimes.com/2008/08/28/the-long-slow-death-of-omnicare> (Aug. 28, 2008, 16:22 EST).

8. Only the effect of deal protection devices on the target is relevant for the purposes of this Essay. The merger agreement can include deal protection provisions aiming at preventing the acquirer from failing to consummate the deal, e.g. reverse termination fees, specific performance provisions for the buyer, etc. However, the dynamics and incentives of such acquirer-directed deal protections are different from

A. Reasons for Protecting the Deal in the  
Context of Corporate Acquisitions

Fostering deal certainty offers advantages for both acquirer and target. Without some form of protection, the original bidder might reasonably fear that its offer will simply be used as a “stalking horse”<sup>9</sup> to secure a better offer and that it might eventually lose the deal in a future bidding war. If the deal is not completed, the initial bidder may suffer a decrease in its own stock price and may be viewed as weak in the market for corporate control.<sup>10</sup>

The main incentive for a bidder to incorporate deal protection devices is to reduce the actual and indirect costs associated with the merger process, including opportunity costs arising from focusing on the potential merger at hand.<sup>11</sup> If the possibility of interference in the merger plans is minimized, the acquirer will more readily risk the significant costs associated with a bid, including advisory fees, loan commitments, research and diligence costs, management time, and foregone business opportunities.<sup>12</sup> When the acquirer invests its resources in evaluating and purchasing a particular target company, it must “abjure other valuable opportunities while negotiating or awaiting the closing of a deal.”<sup>13</sup> If the target decides to walk away from the deal, leaving the initial bidder without a merger partner, it may be too

---

the target-directed deal protection devices. Rival companies are rarely seen attempting to outbid the target by offering themselves to the acquirer for a lower price. In addition, the courts are generally concerned about protecting target shareholders from losing an opportunity to receive a control premium for their shares due to a decision of the board. Cf. Thanos Panagopoulos, *Thinking Inside the Box: Analyzing Judicial Scrutiny of Deal Protection Devices in Delaware*, 3 BERKELEY BUS. L.J. 437, 443-44 (2006).

9. Smith v. Van Gorkom, 488 A.2d 858, 866 (Del. 1985).

10. See Guhan Subramanian, *The Drivers of Market Efficiency in Revlon Transactions*, 28 J. CORP. L. 691, 701-02 (2003).

11. See Brazen v. Bell Atl. Corp., 695 A.2d 43, 45 (Del. 1997). See also Gregory V. Varallo & Srinivas M. Raju, *A Process Based Model for Analyzing Deal Protection Measures*, 55 BUS. LAW. 1609, 1611-12 (2000).

12. See Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1178 (1981). See also Sean J. Griffith, *Deal Protection Provisions in the Last Period of Play*, 71 FORDHAM L. REV. 1899, 1900 (2003).

13. A. Gilchrist Sparks III et al., *Corporate Deal Protection—The Lay of the Land in Delaware*, in CONTESTS FOR CORPORATE CONTROL: CURRENT OFFENSIVE & DEFENSIVE STRATEGIES IN M&A TRANSACTIONS 401, 404 (1351 PLI/CORP. 2003).

late for the bidder to seize those opportunities it originally possessed.<sup>14</sup> Another hidden cost is the economic effect associated with the acquirer losing a deal within its grasp. The company may receive negative publicity and appear to be in a weakened market position, especially if the competing merger is well received by the capital markets.<sup>15</sup>

In addition, there is a free-rider problem: future bidders can rely upon the terms of the first transaction and make certain assumptions about what the first bidder turned up in its investigation of the company.<sup>16</sup> Simple fairness requires that the first bidder is able to protect its due diligence efforts.

“[T]argets have reasons of their own for avoiding non-binding merger agreements. A particular merger may present unique business opportunities or ‘synergies’ for the target that an intervening financial bidder cannot match.”<sup>17</sup> The target board may “see unique benefits from the favored transaction that the target’s shareholders may not recognize . . .”<sup>18</sup> Also, there are increased costs for the target involved in a bidding war, which can be avoided by protecting the deal with the favored bidder from an interloper.

### B. Examples of Deal Protection Devices

Deal protection devices used in corporate acquisitions may be grouped into three categories: (i) compensatory devices, examples of which are termination fees and stock and asset options; (ii) voting protections, such as voting agreements and “force-the-vote” provisions; and (iii) exclusivity measures, for example no-shop and no-talk provisions and matching rights.<sup>19</sup>

---

14. See Heath Price Tarbert, *Merger Breakup Fees: A Critical Challenge to Anglo-American Corporate Law*, 34 L. & POL’Y INT’L BUS. 627, 633 (2003).

15. See *id.*

16. See Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1, 3-7 (1982).

17. See Griffith, *supra* note 12, at 1900-01.

18. See WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 582 (2d ed. 2007). Courts reject this justification for deal protection devices in transactions that trigger *Revlon* duties. In a *Revlon* transaction, the board has no legitimate interests in protecting a deal from an informed shareholder vote.

19. In this section, I discuss classic deal protection devices. Other forms of contracts can have a lockup effect. For example, the sale of one million Trans Union shares to Pritzker in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), was a compensatory device similar to a termination fee. If Trans Union was sold to another

### 1. Termination Fees

A termination fee is a payment to the acquirer in the event the target fails to close the transaction.<sup>20</sup> The triggers can be a changed board recommendation, a negative shareholder vote or the closing of an alternative transaction. A termination fee paid by the target to the jilted acquirer is effectively borne by the winning bidder.

There is no magic number for a reasonable termination fee. Courts will consider all factors,

including without limitation: the overall size of the termination fee, as well as its percentage value; the benefit to shareholders, including a premium (if any) that directors seek to protect; the absolute size of the transaction, as well as the relative size of the partners to the merger; the degree to which a counterparty found such protections to be crucial to the deal, bearing in mind differences in bargaining power; and the preclusive or coercive power of *all* deal protections included in a transaction, taken as a whole.<sup>21</sup>

Appropriate termination fees defy categorical rules: it is wrong to say that “fees lower than 3% are always reasonable,”<sup>22</sup> and at the opposite side of the spectrum, there are “preclusive differences”<sup>23</sup> between termination fees that count in billions rather than in millions. Termination fees in the range of 3-4% of the purchase price are generally believed to present an easily rationalized means to assure the first bidder will recover its transaction expenses, including opportunity costs, if the favored contract does not close. There have been indications that courts will disapprove the amount of the termination fee significantly outside of this range.<sup>24</sup>

---

bidder, the new acquirer would be forced to buy these shares.

20. Terms “break-up fees” and “topping fees” are also used. A topping fee is paid if the target accepts another bidder’s offer, whereas a break-up fee can be paid in the event that the target simply walks away from the deal, not necessarily to another bidder. A topping fee is usually structured in such a way that the target is required to pay a negotiated percentage of the amount by which the subsequent offeror’s bid exceeds the original bid. *See, e.g., CRTF Corp. v. Federated Dep’t Stores, Inc.*, 683 F. Supp. 422, 436 (S.D.N.Y. 1988).

21. *La. Mun. Police Employees’ Ret. Sys. v. Crawford*, 918 A.2d 1172, 1181 (Del. Ch. 2007).

22. *In re Toys “R” Us, Inc. S’holder Litig.*, 877 A.2d 975, 1022 (Del. Ch. 2005).

23. *Id.* at 1022 n.79.

24. In *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, Consolidated Civil Action No. 17383, 1999 Del. Ch. LEXIS 202, at \*5 (Del. Ch. Sept. 27, 1999), the court

## 2. Stock and Asset Options

A stock option is a right granted to the acquirer to buy a block of target's stock at a strike price. An asset option creates a right to acquire specified corporate assets of the target. As with termination fees, options can become exercisable after a changed board recommendation, a negative shareholder vote or the closing of an alternative acquisition; the cost of stock and asset options exercised by the jilted acquirer are effectively borne by the winning bidder.

The amount of a reasonable stock option is not predetermined. In deciding whether a stock option satisfies the reasonableness test, courts will look at its percentage<sup>25</sup> and absolute size.<sup>26</sup> Stock options have virtually disappeared after the elimination of pooling-of-interest accounting in 2001.<sup>27</sup>

Courts have traditionally been more suspicious of asset options for a target's key assets (so-called "crown jewel lockup[s]"<sup>28</sup>) than they are of stock options. Asset options have been virtually non-existent since *Revlon*<sup>29</sup> and *Mills Acquisition v. Macmillan*.<sup>30</sup>

## 3. Voting Agreements and "Force-the-Vote" Provisions

A voting agreement is an agreement between the acquirer and a target's shareholder by which the shareholder undertakes to approve the merger. Understandably, the acquirer is mostly interested in commitments from significant shareholders in order to ensure a majority vote.

A "force-the-vote" provision in the merger agreement requires the

---

stated in dicta that "6.3 percent certainly seems to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point."

25. In *Rand v. W. Air Lines, Inc.*, C.A. No. 8632, 1994 Del. Ch. LEXIS 26, at \*8 (Del. Ch. Feb. 25, 1994), *aff'd*, 659 A.2d 228 (Del. 1995), the Delaware Chancery Court upheld a stock option of approximately 30% granted to the initial bidder.

26. In *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 39 (Del. 1994), the Delaware Supreme Court disallowed a stock option of 19.9% with a large absolute size.

27. See ALLEN ET AL., *supra* note 18, at 581-82.

28. See *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1286 (Del. 1989).

29. See *generally Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

30. In *Revlon*, the Delaware Supreme Court invalidated an asset option for a target division. See *id.* at 175-76. Similarly, in *Mills Acquisition Co.*, 559 A.2d at 1284, an option to purchase target subsidiaries was struck down.

target board to submit the merger agreement for a shareholder vote, even if the target board no longer recommends it.<sup>31</sup> A voting agreement combined with a “force-the-vote” provision in the merger agreement is a strong deal protection.

#### 4. No-Shops and No-Talks

Under a no-shop provision in the merger agreement the target board undertakes not to actively solicit alternative proposals.

A no-shop provision can be further restricted by a no-talk obligation, where the target is prohibited from even talking to unsolicited bidders. Courts have condemned no-talk provisions as “the legal equivalent of willful blindness.”<sup>32</sup> Courts will uphold no-shop provisions where they “do not foreclose other offers, but operate merely to afford some protection to prevent disruption of the agreement by proposals from third parties that are neither bona fide nor likely to result in a higher transaction.”<sup>33</sup>

No-talk provisions impede the flow of information between targets and their would-be bidders, thereby creating an “information asymmetry”<sup>34</sup> to the benefit of the first bidder. Sometimes strict no-talk provisions are regarded as problematic because they prevent the board from meeting its duty to make an “informed judgment.”<sup>35</sup> In other cases challenges to no-talk provisions are rejected.<sup>36</sup>

---

31. “Force-the-vote” provisions were developed in practice after an amendment to Section 251(c) of the Delaware General Corporation Law in 1998 had reduced the impact of the board recommendation as an exclusivity measure. Before this amendment, Section 251(c) was interpreted as precluding a shareholder vote if the board of directors decided no longer to recommend the merger. *See Smith v. Van Gorkom*, 488 A.2d 858, 887-88, 890 (Del. 1985).

32. *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, Consolidated Civil Action No. 17383, 1999 Del. Ch. LEXIS 202, at \*4 (Del. Ch. Sept. 27, 1999).

33. *Matador Capital Mgmt. Corp. v. BRC Holdings, Inc.*, 729 A.2d 280, 291 (Del. Ch. 1998).

34. Griffith, *supra* note 12, at 1930.

35. *Phelps Dodge Corp.*, 1999 Del. Ch. LEXIS 202, at \*4.

36. *See In re IXC Communications, Inc. S’holders Litig.*, Consolidated C.A. No. 17324, 1999 Del. Ch. LEXIS 210, at \*\*16-17 (Del. Ch. Oct. 27, 1999).



### 5. Matching Rights

A matching right operates as a “last look”<sup>37</sup> provision. The acquirer has the right to match a superior bid, usually within a specified period of time. Knowing that, an interloper will most likely not bid at all.

### C. Deal Protection Devices and Directors’ Fiduciary Duties

The inclusion of deal protection devices into a merger agreement leads to an inherent tension.<sup>38</sup> The target company’s board owes fiduciary duties to the company shareholders. These fiduciary obligations may constrain the board’s ability to agree to limit its conduct in the manner that the bidder demands under the terms of the deal protection device the bidder proposes to include in the parties’ acquisition agreement.

Under Delaware law, the business and affairs of a Delaware corporation are managed by, or under the direction of, a board of directors.<sup>39</sup> This responsibility “carries with it certain fundamental fiduciary obligations to the corporation and its shareholders.”<sup>40</sup> The core duties are those of due care and loyalty; in addition, the directors must act in good faith.<sup>41</sup> The duty of care requires the directors to act with “that amount of care which ordinarily careful and prudent men would use in similar circumstances.”<sup>42</sup> This means there must be a “good faith effort to be informed and to exercise appropriate judgment . . .”<sup>43</sup> The duty of loyalty has been described as “the punctilio of an

---

37. *La. Mun. Police Employees’ Ret. Sys. v. Crawford*, 918 A.2d 1172, 1180 (Del. Ch. 2007).

38. *Cf.* ROBERT CHARLES CLARK, *CORPORATE LAW* 123 (1986) (noting that courts have long recognized the tension in corporate law between directors’ discretion and accountability). *Cf.* *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 930 (Del. 2003) (“There are inherent conflicts between a board’s interest in protecting a merger transaction it has approved, the stockholders’ statutory right to make the final decision to either approve or not approve a merger, and the board’s continuing responsibility to effectively exercise its fiduciary duties at all times after the merger agreement is executed.”).

39. DEL. CODE ANN. tit. 8, § 141(a) (2009).

40. *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984).

41. “The directors of Delaware corporations have a triad of primary fiduciary duties: due care, loyalty and good faith.” *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001).

42. *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963).

43. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996)

honor the most sensitive . . . .”<sup>44</sup> Directors should not “prefer[] the adverse self-interest of the fiduciary . . . to the interest of the corporation . . . .”<sup>45</sup> The duty to act in good faith is violated in cases of “intentional dereliction of duty, a conscious disregard for one’s responsibilities,”<sup>46</sup> or where the directors act “for some purpose other than a genuine attempt to advance corporate welfare.”<sup>47</sup>

Under the business judgment rule, there is a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”<sup>48</sup> This “rule operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation.”<sup>49</sup> Accordingly, the directors’ “decisions will not be disturbed if they can be attributed to any rational business purpose.”<sup>50</sup> “The business judgment rule shields directors from judicial second-guessing for all but the most careless acts, and court will only consider the substantive fairness of a deal when the loyalty of directors is compromised by a conflict of interest.”<sup>51</sup>

Notwithstanding the general applicability of the business judgment rule, Delaware courts have employed heightened standards for the review of certain corporate actions: *Revlon* and *Unocal* standards.<sup>52</sup>

Board conduct can be subject to enhanced scrutiny under the *Revlon* standard. *Revlon* did not however create any new fiduciary duties. In a *Revlon* situation, the board must perform its fiduciary duties in the service of a specific objective: “maximizing the sale price of the

---

(emphasis omitted).

44. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

45. *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 66 (Del. 2006).

46. *Id.* at 63.

47. *Gagliardi v. Trifoods Int’l, Inc.*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996) (emphasis omitted) (citing *Miller v. AT&T Co.*, 507 F.2d 759 (3d Cir. 1974)).

48. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

49. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993).

50. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

51. See Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of Omnicare v. NCS Healthcare*, 29 J. CORP. L. 569, 576 (2004).

52. In addition to the *Revlon* and *Unocal* tests, the *Blasius* standard of review applies where a board action specifically attempts to interfere with a shareholder vote. In this case, the directors must demonstrate a “compelling justification” for their actions. See generally *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). It is, however, not clear whether *Blasius* applies to shareholder votes in the merger context. See *Mercier v. Inter-Tel (Del.) Inc.*, 929 A.2d 786, 809 (Del. Ch. 2007).

company for the stockholders' benefit."<sup>53</sup> How to achieve this objective is up to the board. "[T]here is no single blueprint that a board must follow to fulfill its duties."<sup>54</sup>

Although [the *Revlon*] enhanced scrutiny test involves a review of the reasonableness of the substantive merits of a board's actions, a court should not ignore the complexity of the directors' task in a sale of control. There are many business and financial considerations implicated in investigating and selecting the best value reasonably available. The board of directors is the corporate decision-making body best equipped to make these judgments. Accordingly, a court applying enhanced judicial scrutiny should be deciding whether the directors made a reasonable decision, not a perfect decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's decision. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness.<sup>55</sup>

*Revlon* duties are triggered when there is a change of control caused by a cash-out merger or a break-up of the corporate entity.<sup>56</sup>

Where the *Unocal* test is applicable, "the board must establish: (1) that it had reasonable grounds to believe that the hostile bid for control threatened corporate policy and effectiveness; and (2) that the defensive measures adopted were reasonable in relation to the threat posed."<sup>57</sup> This latter proportionality inquiry involves a two-step analysis. The first part of the test is met by showing the response was not "draconian,"<sup>58</sup> i.e. not "coercive or preclusive,"<sup>59</sup> and the second – that the response was within the "range of reasonableness"<sup>60</sup> to the perceived threat. A response is "coercive" if it is aimed at forcing upon stockholders a

---

53. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986).

54. *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989).

55. *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 45-46 (Del. 1994) (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955-56 (Del. 1985)).

56. *Id.*

57. *Chesapeake Corp. v. Shore*, 771 A.2d 293, 330 (Del. Ch. 2000).

58. *See Unocal*, 493 A.2d at 955.

59. *See Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1365 (Del. 1995).

60. *Id.* at 1388.

management-sponsored alternative to a hostile offer.<sup>61</sup> A response is “preclusive” if it deprives stockholders of the right to receive all tender offers or precludes a bidder from seeking control by fundamentally restricting proxy contests or otherwise.<sup>62</sup> This level of scrutiny applies “whenever the record reflects that a board of directors took defensive measures in response to a ‘perceived ‘threat to corporate policy and effectiveness which touches upon issues of corporate control.’”<sup>63</sup> The *Unocal* standard applies “[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders.”<sup>64</sup>

## II. THE *OMNICARE* DECISION: LIMITS ON DEAL PROTECTION DEVICES

On April 4, 2003 the Delaware Supreme Court rendered a rare three-two split decision that imposed certain limits on deal protection devices used in corporate acquisition transactions.<sup>65</sup> This decision generated vigorous critiques in the literature<sup>66</sup> and was even perceived to threaten to “[f]undamentally [a]lter the [m]erger [i]ndustry.”<sup>67</sup>

---

61. See *id.* at 1387.

62. See *id.*

63. *Id.* at 1372 n.9 (citing *Stroud v. Grace*, 606 A.2d 75, 82 (Del. 1992)).

64. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

65. Before *Omnicare*, the deal protection jurisprudence was inconsistent. In *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, Consolidated Civil Action No. 17383, 1999 Del. Ch. LEXIS 202 (Del. Ch. Sept. 27, 1999); *ACE Ltd. v. Capital Re Corp.*, 747 A.2d 95 (Del. Ch. 1999); and *McMillan v. Intercargo Corp.*, 768 A.2d 492 (Del. Ch. 2000), the Delaware Chancery Court called into question the validity of deal protection measures, suggesting that they should be reviewed under the *Unocal* standard. In *In re LXC Communications, Inc. S'holders Litig.*, Consolidated C.A. No. 17324, 1999 Del. Ch. LEXIS 210, at \*7 (Del. Ch. Oct. 27, 1999) and *Wisconsin Investment Board v. Bartlett*, C.A. No. 17727, 2000 Del. Ch. LEXIS 42, at \*\*30-31 (Del. Ch. Feb. 24, 2000), the court suggested that deal protection measures should be valid after a properly conducted reasonableness review that gives due deference to the target board's business judgment. See generally Varallo & Raju, *supra* note 11.

66. Professor Eric A. Chiappinelli predicted that *Omnicare* would become the most controversial corporate case of the past 20 years. See Robin Sidel, *Deals & Deal Makers: Merger Business Faces New Order with Court Ruling on 'Lockups'*, WALL ST. J., Apr. 7, 2003, at C4.

67. See Brian C. Smith, *Changing the Deal: How Omnicare v. NCS Healthcare Threatens to Fundamentally Alter the Merger Industry*, 73 MISS. L.J. 983 (2004).

A. Factual Background and Holding

NCS Healthcare, Inc., a troubled pharmacy services provider that was insolvent in 2001, was the object of competing acquisition bids by Genesis Health Ventures, Inc. and Omnicare, Inc. The stock-for-stock merger agreement between NCS and Genesis was negotiated for NCS by an Independent Committee consisting of two of four NCS directors: Boake Sells and Richard Osborne.<sup>68</sup> The Genesis merger agreement contained a “force-the-vote” provision, which required that the agreement be submitted to the NCS shareholders for a vote even if the NCS board no longer recommended it.<sup>69</sup> Two NCS shareholders, Jon Outcalt<sup>70</sup> and Kevin Shaw,<sup>71</sup> were owners of Class B common shares, which, although virtually identical in every other respect to the Class A common shares, were entitled to ten times more votes per share than Class A shares. These two shareholders, although owning about 20% of NCS outstanding stock, held a majority (over 65%) of the NCS voting power and agreed unconditionally to vote all of their shares in favor of the Genesis merger.<sup>72</sup> In addition, Outcalt and Shaw undertook not to transfer their shares prior to the shareholder vote on the merger agreement and granted to Genesis an irrevocable proxy to vote their shares in favor of the merger agreement. The voting agreements were specifically enforceable by Genesis. The merger agreement provided that, if either Outcalt or Shaw breached the voting agreements, Genesis would be entitled to receive the agreed termination fee (\$6 million). The merger agreement contained an obligation for NCS, in the event of agreement termination, to pay Genesis’s documented expenses, in the amount of up to \$5million.<sup>73</sup> The merger agreement contained a no-shop obligation for NCS, which was subject to a fiduciary-out.<sup>74</sup>

After the Genesis merger agreement had been signed, Omnicare<sup>75</sup> filed a lawsuit attempting to invalidate the Genesis merger agreement and the voting agreements between Genesis and Outcalt and Shaw. At

---

68. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 922 (Del. 2003). The authority to approve any transaction remained with the full four-member board. *Id.*

69. *Id.* at 918.

70. Outcalt was also Chairman of the NCS board of directors. *Id.*

71. Shaw was President, CEO, and a director of NCS. *Id.* at 918-19.

72. *Id.*

73. *Id.* at 926.

74. *Id.* at 925-26.

75. Omnicare had purchased a minor stock in NCS shortly before the lawsuit was filed. *Id.* at 919, 926.

the same time, Omnicare submitted to the NCS board an irrevocable all-cash proposal that was superior to the Genesis deal. As a result, the NCS board withdrew its endorsement of the Genesis merger and instead recommended that NCS shareholders reject the Genesis transaction.<sup>76</sup> However, the NCS board still had to submit the Genesis merger agreement for a shareholder vote and two major NCS shareholders were bound by the terms of their voting agreements with Genesis.

In addition, certain other NCS shareholders sought to invalidate the Genesis merger agreement.<sup>77</sup>

The Delaware Supreme Court accepted, for the purposes of the legal review at hand, the reasoning of the Chancery Court that because the stock-for-stock merger agreement between NCS and Genesis did not result in change of control and NCS did not start an active bidding process, the directors' duties under *Revlon* were not triggered. Therefore, the *Revlon* standard of enhanced judicial scrutiny was inapplicable.

The court held, however, that the deal protection devices contained in the NCS/Genesis merger agreement were subject to the *Unocal* enhanced judicial scrutiny test.<sup>78</sup> The court applied the two-prong test of *Unocal*. The NCS directors must first demonstrate "that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed . . . ."<sup>79</sup> To satisfy that burden, the NCS directors were required to show that they acted in good faith after conducting a reasonable investigation. The threat identified by the NCS board was the possibility of losing the Genesis offer and being left with no comparable alternative transaction. The second stage of the *Unocal* test required the NCS directors to demonstrate that their defensive response was "reasonable in relation to the threat posed."<sup>80</sup> This latter proportionality inquiry involved a two-step analysis. The NCS directors had to establish that the deal protection devices adopted in response to the threat were neither coercive nor preclusive, and then demonstrate that their response was within a "range of reasonableness"<sup>81</sup> to the perceived threat.

In the context of a shareholder vote, coercion exists "where the

---

76. *Id.* at 927.

77. *Id.* at 919.

78. *Id.* at 934.

79. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

80. *Id.*

81. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1388 (Del. 1995).

board or some other party takes actions which have the effect of causing the stockholders to vote in favor of the proposed transaction for some reason other than the merits of that transaction.”<sup>82</sup> The court ruled that, because the arrangements with Genesis rendered an alternative deal “mathematically impossible,”<sup>83</sup> a “*fait accompli*,”<sup>84</sup> the deal protection measures were designed to coerce the consummation of the Genesis merger and preclude the consideration of a superior transaction by NCS stockholders and, therefore, violated the principles of *Unocal/Unitrin*. The court held that the deal protection devices were also invalid and unenforceable on the alternate grounds that the merger agreement provided no effective fiduciary-out.<sup>85</sup>

B. Omnicare’s Standard Applicable to Deal Protection Devices:  
Unocal Enhanced Judicial Scrutiny

*Unocal* established that enhanced judicial scrutiny should be applied to a board’s adoption of defensive measures in response to a hostile takeover proposal that the board believes is a threat to corporate policy and effectiveness.<sup>86</sup> The majority in *Omnicare* explained its reasons for applying the *Unocal* test to deal protection devices:

There are inherent conflicts between a board’s interest in protecting a merger transaction it has approved, the stockholders’ statutory right to make the final decision to either approve or not approve a merger, and the board’s continuing responsibility to effectively exercise its fiduciary duties at all times after the merger agreement is executed. . . . A board’s decision to protect its decision to enter a merger agreement with defensive devices against uninvited competing transactions that may emerge is analogous to a board’s decision to protect against dangers to corporate policy and effectiveness when it adopts defensive measures in a hostile takeover contest.<sup>87</sup>

The Delaware Chancery Court stated that deal protection provisions are of “obviously defensive nature.”<sup>88</sup> Some commentators argued that

---

82. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 935 (Del. 2003) (citing *Williams v. Geier*, 671 A.2d 1368, 1382-83 (Del. 1996)).

83. *Id.* at 936.

84. *Id.*

85. *Id.* at 937.

86. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985).

87. *Omnicare*, 818 A.2d at 930, 932.

88. *McMillan v. Intercargo Corp.*, 768 A.2d 492, 506 n.62 (Del. Ch. 2000).

deal protection provisions defend the merger agreement and therefore are “inherently defensive,”<sup>89</sup> because their adoption gives rise to the same potential conflict of interest as do directors’ defensive actions in the event of hostile takeover threat. Under this reasoning, *Unocal* enhanced scrutiny should be the proper standard for judicial review of deal protections.<sup>90</sup>

Other commentators, arguing in support of *Omnicare*, contend that sellers should be prohibited from providing buyers in non-*Revlon* transactions with “bulletproof”<sup>91</sup> protection. Instead, sellers should be permitted to provide protection only to the extent necessary to compensate bidders for the transaction and for the opportunity costs of making bids. A well-measured termination fee should be sufficient for this purpose. Limiting the ability of selling boards to grant bulletproofing will result in enhanced social welfare. There are structural biases in the bargaining process that make it difficult for sellers to resist bulletproof transactions in a bilateral negotiation. These biases make it necessary to have a mandatory rule that prevents sellers from agreeing to bulletproof a transaction.<sup>92</sup>

The *Omnicare*-majority supportive view remains a minority view in the literature.

### C. *Omnicare*’s Dissents

Dissenting to the majority in *Omnicare*, Chief Justice Veasey argued that “[t]he *Unocal* doctrine applies to unilateral board actions that are defensive and reactive in nature,”<sup>93</sup> and therefore that *Unocal* should not apply in the friendly merger context. In this case, the business judgment rule should apply to a board of directors’ decision that is free from self-interest, made with due care, and in good faith.<sup>94</sup>

---

89. Mark Lebovitch & Peter B. Morrison, *Calling a Duck a Duck: Determining the Validity of Deal Protection Provisions in Merger of Equals Transactions*, 2001 COLUM. BUS. L. REV. 1, 14 (2001).

90. *Id.* at 8.

91. *Omnicare*, 818 A.2d at 923.

92. See Brian J.M. Quinn, *Bulletproof: Mandatory Rules for Deal Protection*, 32 IOWA J. CORP. L. 865, 867 (2007).

93. *Omnicare*, 818 A.2d at 943 n.102 (Veasey, C.J., dissenting). Cf. Williams v. Geier, 671 A.2d 1368, 1377 (Del. 1996) (“A *Unocal* analysis should be used only when a board unilaterally (i.e., without shareholder approval) adopts defensive measures . . .”).

94. *Omnicare*, 818 A.2d at 940 (Veasey, C.J., dissenting); *id.* at 947 (Steele, J.,



Justice Veasey reasoned that there was no threat that the board was acting out of its own self-interest; therefore, the deal protection devices should not be considered defensive.<sup>95</sup>

Justice Veasey further reasoned that, even if *Unocal* was applicable, the measures protecting the Genesis merger were neither coercive nor preclusive. Such measures were adopted by Shaw and Outcalt through the lens of their independent assessment of the merits of the transaction. Genesis would not save NCS, its creditors and its stockholders without these provisions. The deal protection measures were an integral part of the merits of the transaction.<sup>96</sup>

Justice Veasey stated that the absolute requirement of a fiduciary-out, as stipulated in the majority's opinion, was unsupported by Delaware case law and invited unwarranted judicial review into the risk/return analysis of boards of directors, which had traditionally been granted judicial deference under the business judgment rule.<sup>97</sup>

#### D. Critique of the Majority in *Omnicare*

*Omnicare* was "bad law, bad economics and bad policy."<sup>98</sup> In addition to the legal arguments used by the *Omnicare*'s dissenting judges, the following arguments support the critique.

The *Omnicare* ruling is based on two grounds: reasonableness-proportionality under *Unocal* and anti-disablement under *QVC*.

Application of the *Unocal* standard to deal protection devices in friendly mergers is debatable.<sup>99</sup> In addition, application of the *Unocal*

---

dissenting).

95. *Id.* at 940 (Veasey, C.J., dissenting); *id.* at 947 (Steele, J., dissenting). *Cf.* Griffith, *supra* note 12, at 1913 ("[I]t is not at all clear how the 'threat' [from the *Unocal* threat/response paradigm] should be defined in . . . a friendly deal.").

96. *Id.* at 943-44 (Veasey, C.J., dissenting).

97. *Id.* at 945 (Veasey, C.J., dissenting); *id.* at 948 (Steele, J., dissenting).

98. Griffith, *supra* note 51, at 623. The majority in *Omnicare* seems to have been motivated by pretextual issues. The court was troubled by the voting control held by two majority shareholders via heavy-voting Class B shares. Also, there are indications of the court's suspicions of procedural due care violation. *See* Daniel C. Davis, *Omnicare v. NCS Healthcare: A Critical Appraisal*, 4 BERKELEY BUS. L.J. 177, 191-94 (2007). In addition, the court seems to have been suspicious of duty of loyalty violation by the two directors who were also shareholders, vis-à-vis minority shareholders. "[T]he stockholder voting agreements were inextricably intertwined with the defensive aspects of the Genesis merger agreement." *Omnicare*, 818 A.2d at 934.

99. *See supra* note 95 and accompanying text. It could be argued that, in practical

standard in a non-*Revlon* situation, where the target board does not have to maximize short-term shareholder welfare, is unreasonably strict. The *Unocal* analysis as applied to deal protection devices creates a catch-22 situation:<sup>100</sup> if the deal protection devices are coercive or preclusive, they are not within a range of reasonable responses under the proportionality requirement; but those devices may be outside the range of reasonable responses even if not coercive or preclusive under the reasonable threat requirement.<sup>101</sup>

Even applying the *Unocal* analysis one should come to the conclusion that the deal protection measures in the Genesis merger agreement were not unreasonably coercive. Under the *Williams* test, an action coercive for the shareholders must be designed to obtain a shareholder approval of a transaction that is not based on the transaction's merits.<sup>102</sup> What reasons, other than the merits of the transaction, caused NCS shareholders to vote in favor of the proposed transaction? First, one should ask which shareholders the court need concern itself with. The deal protections were not coercive as to the controlling shareholders, Outcalt and Shaw in this case. *Omnicare* was not a case where the board had imposed something on the shareholders; Outcalt and Shaw voluntarily signed the voting agreements with Genesis.<sup>103</sup> In this case, the court should have focused its inquiry on the deal protection's impact on the public shareholders:

---

effect, *Unocal* has "little critical bite." Marcel Kahan, *Paramount or Paradox: The Delaware Supreme Court's Takeover Jurisprudence*, 19 J. CORP. L. 583, 585 (1994). "*Unocal* . . . no longer substantially constrains board conduct." Griffith, *supra* note 12, at 1914 n.57. Griffith refers to a study conducted by Professors Robert B. Thompson and Gordon D. Smith, which showed that between 1985 and 2000, the Delaware Supreme Court let all board defensive actions outside of a *Revlon* context pass the *Unocal* test. However, it was the application of the *Unocal* test that rendered the deal protection devices in the NCS/Genesis merger agreement invalid.

100. The court in *Omnicare* called it "disjunctive analysis." *Omnicare*, 818 A.2d at 935.

101. See *Orman v. Cullman*, Civ. A. No. 18039, 2004 Del. Ch. LEXIS 150, at \*\*25-26 (Del. Ch. Oct. 20, 2004).

102. See *Williams v. Geier*, 671 A.2d 1368, 1382-83 (Del. 1996).

103. In addition, it was not a regular conflict-of-interest situation, where the director represents the corporation on one side of the transaction, e.g., as buyer, and simultaneously acts on the other side of the same transaction in the individual capacity, e.g., as seller. The directors Outcalt and Shaw were, by virtue of their shareholder position, naturally interested in the highest price for their shares. By locking-up the allegedly less valuable deal with Genesis they deprived themselves of the additional premium they would receive from the *Omnicare* deal.

NCS's public shareholders (who owned 80% of NCS and overwhelmingly supported the Omnicare's offer) will be forced to accept the Genesis merger because of the structural defenses approved by the NCS board. Consequently, the record reflects that any stockholder vote would have been robbed of its effectiveness by the impermissible coercion that predetermined the outcome of the merger without regard to the merits of the Genesis transaction at the time the vote was scheduled to be taken.<sup>104</sup>

Class A public shareholders were effectively disenfranchised, as they did not have enough voting power to either accept or reject the deal. Ultimately, the inability of the Class A shareholders to effect the outcome of the merger, and not the structural devices approved by the NCS board, made public shareholders accept the Genesis merger.<sup>105</sup>

The majority in *Omnicare* was correct that minority shareholders should receive protection against coercive and preclusive bids approved by the board, but this protection should not go so far as to impair the right of the majority to vote their shares as they see fit.<sup>106</sup> The court in *Unitrin* did not mention the minority shareholder franchise; the minority protection language in *Omnicare* came from *QVC*. However, since the Genesis merger agreement was not subject to *Revlon* scrutiny, the fiduciary duty language of *QVC* was inapplicable.<sup>107</sup> As the Delaware Chancery Court stated later in *Orman v. Cullman*, "it cannot be the case that whenever a controlling stockholder can vote against a sale the out-voted minority can assert a coercion claim."<sup>108</sup> "Our [j]urisprudence [d]oes [n]ot [c]ompel . . . [c]ourt[s] to [i]nvalidate the [j]oint [a]ction of the [b]oard and the [c]ontrolling [s]tockholders."<sup>109</sup>

To achieve the same result as a combination of voting agreements

104. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 935-36 (Del. 2003).

105. Cf. Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft*, 60 BUS. LAW. 877, 901 & n.97 (2005):

[S]tockholders who controlled a majority of the votes and who were receiving the same per share consideration as the minority, had approved the transaction, meaning that free and unconflicted stockholder choice was vindicated . . . . Once a court concludes . . . that a controlling stockholder has no interest in conflict from that of the other stockholders, the controlling stockholder's own choice to approve a transaction becomes very strong evidence of the fairness of accepting that deal.

106. See Smith, *supra* note 67, at 999.

107. See *Omnicare*, 818 A.2d at 945-46 (Veasey, C.J., dissenting).

108. *Orman v. Cullman*, Civ. A. No. 18039, 2004 Del. Ch. LEXIS 150, at \*33 n.92 (Del. Ch. Oct. 20, 2004).

109. *Omnicare*, 818 A.2d at 942 (Veasey, C.J., dissenting).

with the majority shareholders and a 'force-the-vote' provision in the merger agreement, Outcalt and Shaw could simply have signed written consents.<sup>110</sup> This tactic was subsequently endorsed by the Delaware Chancery Court, in *Optima v. WCI*.<sup>111</sup>

The problem with the application of the anti-disablement argument under *QVC* is that the absence of a change of control in *Omnicare* represented a critical distinction between *Omnicare* and *QVC*.<sup>112</sup>

The risk of self-interest for the board in locked-up deals could be countered by imposing a market-check requirement on the board. A market check can be either pre-signing or post-signing.<sup>113</sup> An active market check might impose certain constraints into what might otherwise be an unconstrained decision by a self-serving board by reintroducing the market for corporate control into the merger process.<sup>114</sup>

Applying the *Unocal* test to deal protection devices can cause practical difficulty. In addition, "the test would appear to result in judicial invalidation of negotiated contractual provisions based on the advantages of hindsight."<sup>115</sup> The board, at the time of adopting deal protections, cannot know the terms of a future transaction. "[T]he NCS board's good faith decision must be subject to a real-time review of the board action . . . ." <sup>116</sup>

The *Omnicare* ruling threatened to prohibit merger agreements to provide the initial acquirer with certainty that its transaction will close. This certainty is not only in the interests of the acquirer, but also in the interests of the target. It has a value that can be traded; it is a

---

110. Section 228 of Delaware General Corporation Law allows for written consents in lieu of shareholder meeting, unless otherwise provided in the certificate of incorporation. See DEL. CODE ANN. tit. 8, § 228(a) (2010).

111. See *infra* Part III.E.

112. See *supra* note 107 and accompanying text.

113. See *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286-87 (Del. 1989). Cf. *Griffith*, *supra* note 51, at 615-22. This argument was used by Delaware courts prior to *Omnicare*. In two pre-*Omnicare* decisions the court held that where the target board had engaged in some form of a market test, business judgment deference to the board's actions would be appropriate. *In re IXC Communications, Inc. S'holders Litig.*, C.A. No. 17334, 1999 Del. Ch. LEXIS 210 (Del. Ch. Oct. 27, 1999); *Wisconsin Inv. Bd. v. Bartlett*, C.A. No. 17727, 2000 Del. Ch. LEXIS 42 (Del. Ch. Feb. 24, 2000).

114. See *Griffith*, *supra* note 51, at 618.

115. *Orman v. Cullman*, Civ. A. No. 18039, 2004 Del. Ch. LEXIS 150, at \*35 n. 98 (Del. Ch. Oct. 20, 2004).

116. *Omnicare*, 818 A.2d at 940 (Veasey, C.J., dissenting).

“[v]aluable [t]rading [c]ommodity.”<sup>117</sup> A lockup permits a target board and a bidder to “exchange certainties”<sup>118</sup> by way of requiring the acquirer to pay a premium for the increased certainty that the transaction will be consummated. Improved transactional certainty increases target shareholder welfare,<sup>119</sup> and most corporate law scholars address efficiency concerns from the perspective of shareholder welfare maximization. As Justice Veasey noted in his *Omnicare* dissent, “[s]ituations will arise where business realities demand a lock-up so that wealth-enhancing transactions may go forward.”<sup>120</sup>

If the target board loses the ability to pre-commit, no reservation value will be put on the table by the first bidder in the beginning; the acquirer will simply discount its bid to reflect its uncertainty concerning target’s commitment.<sup>121</sup> Some bidders will not bid at all.

As a matter of policy, the *Omnicare* majority was correctly criticized for announcing a per se rule that seemed to exceed the Delaware courts’ traditional equitable authority and tended toward quasi-legislative lawmaking. The key issue of the attack by the *Omnicare* majority was the combined effect of the shareholder voting agreements and the “force-the-vote” provision in the merger agreement. Both such instruments, however, were specifically authorized by statute.<sup>122</sup>

### III. LIMITING OMNICARE

Against expressed fears,<sup>123</sup> *Omnicare* did not fundamentally alter the merger landscape. Rather, the courts’ approach to deal protection devices has been changing after *Omnicare*. Post-*Omnicare* case law shows that the narrow view of the holding in *Omnicare* has prevailed, as

---

117. Griffith, *supra* note 51, at 613.

118. *Omnicare*, 818 A.2d at 942 (Veasey, C.J., dissenting) (citing *Rand v. W. Air Lines, C.A. No. 8632*, 1994 Del. Ch. LEXIS 26 (Del. Ch. Feb. 25, 1994), *aff’d*, 659 A.2d 228 (Del. 1995)).

119. See Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423 (1993) (“Shareholder wealth maximization long has been the fundamental norm which guides U.S. corporate decisionmakers.”).

120. *Omnicare*, 818 A.2d at 942 (Veasey, C.J., dissenting).

121. Cf. Griffith, *supra* note 51, at 614.

122. See Strine, *supra* note 105, at 898-99.

123. See Smith, *supra* note 67, at 983-84.

suggested by Justice Veasey in his dissent.<sup>124</sup>

Courts have been limiting *Omnicare* in the context of non-*Revlon* transactions by either distinguishing the facts from *Omnicare* or applying a different standard of review: the business judgment rule.

If the parties can distinguish the merger's circumstances and convince a court the deal protection measures in question did not make the transaction a *fait accompli*, then deal protection devices are not coercive (*Orman v. Cullman*). Alternatively, courts can apply the business judgment rule instead, as in *Bear Stearns*<sup>125</sup> and *Ehrenhaus v. Baker*.<sup>126</sup> Even in judicial review of *Revlon* transactions, the limits of reasonableness have been loosened towards "business logic"<sup>127</sup> and business judgment (*Toys "R" Us, Topps*,<sup>128</sup> *Lear*, *Optima v. WCI*, *Ryan v. Lyondell*<sup>129</sup>).

#### A. *Orman v. Cullman*

##### 1. Factual Background and Holding

Swedish Match AB, a Swedish tobacco company, intended to merge with General Cigar Holdings, Inc., a cigar manufacturer. General Cigar was controlled by the Cullman family. The Cullmans' control was by virtue of a dual-class structure: the family's Class B common stock was entitled to ten votes per share. As a result, shareholders unaffiliated with the Cullmans did not have voting control.<sup>130</sup> Edgar Cullman, Sr. was General Cigar chairman and Edgar Cullman, Jr. was CEO. The merger agreement with Swedish Match was negotiated by a special committee consisting of non-Cullman family members. The special committee was however not authorized to solicit offers from third

---

124. See *Omnicare*, 818 A.2d at 946 (Veasey, C.J., dissenting). Cf. Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729, 758 n.118 (2008) ("Post-*Omnicare* decisions in the Delaware Court of Chancery have already cut back on its scope.").

125. *In re Bear Stearns Litig.*, 870 N.Y.S.2d at 718.

126. *Ehrenhaus v. Baker*, Civil Action No. 08 CVS 22632, 2008 NCBC LEXIS 21, at \*\*95-104 (N.C. Super. Ct. Dec. 5, 2008).

127. *In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 116 (Del. Ch. 2007).

128. *In re Topps Co. S'holders Litig.*, 926 A.2d 58 (Del. Ch. 2007).

129. *Ryan v. Lyondell Chem. Co.*, C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105 (Del. Ch. July 29, 2008), *rev'd*, 970 A.2d 235 (Del. 2009).

130. *Orman v. Cullman*, Civ. A. No. 18039, 2004 Del. Ch. LEXIS 150, at \*6 n.15 (Del. Ch. Oct. 20, 2004).

parties.<sup>131</sup> The merger agreement contained no termination fee.<sup>132</sup> It permitted General Cigar's board to entertain unsolicited acquisition proposals from third parties if the board concluded that such a proposal was bona fide and would be more favorable to the non-affiliated shareholders.<sup>133</sup> "The [merger] agreement also permitted the board to withdraw its recommendation . . . if the board concluded . . . that its fiduciary duties so required."<sup>134</sup> The Cullman family undertook not to sell their shares or vote for any alternative acquisition proposal for 18 months following the termination of the merger agreement.<sup>135</sup> The merger was conditioned upon a separate class vote by the Class A shareholders; the Cullman family agreed to vote their Class A shares pro rata in accordance with the vote of the non-affiliated Class A shareholders.<sup>136</sup>

A non-affiliated shareholder, Joseph Orman, sued the General Cigar board for breach of fiduciary duties in negotiating the merger terms.

The Delaware Chancery Court ruled that by entering into a voting agreement with Swedish Match, the Cullman directors did not breach their fiduciary duties. "Nothing in the voting agreement prevented the Cullmans from exercising their duties as officers and directors."<sup>137</sup> The court applied the *Unocal* enhanced scrutiny test to the deal protection provisions in the merger agreement. It held that at the *Unocal* first step the board demonstrated that it had reasonable grounds for believing that a danger to corporate policy and effectiveness existed, since without accepting the deal protections General Cigar risked losing the Swedish Match deal. At the second *Unocal* step, the deal protections were found not to be coercive<sup>138</sup> because the General Cigar board had negotiated a fiduciary-out, the non-affiliated shareholders retained the power to reject the proposed merger with Swedish Match and a third party was not precluded from going forward with an alternative transaction.<sup>139</sup>

---

131. *Id.* at \*6.

132. *Id.* at \*8.

133. *Id.* at \*12.

134. *Id.* at \*\*12-13.

135. *Id.* at \*10.

136. *Id.* at \*\*6 n.15, 13-14 & n.44.

137. *Id.* at \*21 (emphasis omitted).

138. *Id.* at \*28 n. 81. The plaintiff did not argue that the deal protection provisions were "preclusive," so that only "coercion" was at issue.

139. *Id.* at \*\*31-32.

## 2. Factual Distinctions?

Under the merger agreement's terms, the Cullmans' control over General Cigar was to be shared with Swedish Match.<sup>140</sup> Therefore it was a non-*Revlon* transaction. The court distinguished this case from both *QVC* and *Omnicare*. It pointed out that the Cullmans had entered into a voting agreement as shareholders. This allegedly "meaningful"<sup>141</sup> factual distinction is counterfactual. Outcalt and Shaw in *Omnicare* signed their voting agreements with Genesis not in their capacity as NCS directors, but as shareholders, just as the Cullmans did.<sup>142</sup>

The court distinguished the transaction from *Omnicare*, reasoning: (i) the minority shareholders could veto the deal; and (ii) a third party was not precluded by the 18-month abstention period stipulated in the Cullmans' voting agreement. The court stated that the Cullmans' agreement to vote their Class A shares pro rata in accordance with the vote of the non-affiliated shareholders effectively gave the non-affiliated shareholders veto power over the proposed merger.<sup>143</sup> However, if the non-affiliated shareholders used their veto power, they would not be able to reap the fruits of another deal for 18 months due to the Cullmans' voting agreement.

To what degree was the merger of General Cigar and Swedish Match a *fait accompli*? Apparently none, as the court found that it was not a *fait accompli*. The court acknowledged that the vote of the non-affiliated shareholders "may have been influenced by the existence of the deal protection measures,"<sup>144</sup> but since "no other suitor was waiting in the wings"<sup>145</sup> the court did not find that this influence amounted to an impermissible coercion.<sup>146</sup> The argument that a third-party bidder was not precluded by the 18-month abstention obligation in the Cullmans' voting agreement, although theoretically correct, failed to recognize that no other deal within the next 18 months was possible in practice.

The court honored the voting agreement entered into by the

---

140. *Id.* at \*4 & n.11.

141. *Id.* at \*21.

142. *See supra* notes 70-71 and accompanying text. *Cf.* Davis, *supra* note 98, at 187.

143. *Orman v. Cullman*, Civ. A. No. 18039, 2004 Del. Ch. LEXIS 150 at \*\*13-14 (Del. Ch. Oct. 20, 2004).

144. *Id.* at \*31.

145. *Id.* at \*36.

146. *Id.* at \*37.



Cullmans as majority shareholders. “A majority shareholder has discretion as to when to sell his stock and to whom, a discretion that comes from the majority shareholder’s rights *qua* shareholder.”<sup>147</sup> This statement was supported by a reference to *Omnicare*: “[t]he stockholders with majority voting power . . . had an absolute right to sell or exchange their shares with a third party at any price.”<sup>148</sup> However, in *Omnicare* this “absolute right” of the majority shareholders did not preclude the court from invalidating the deal protections on the grounds of their coerciveness for the minority shareholders.<sup>149</sup>

Although the results of application of the *Unocal* test were different from *Omnicare*, which was based on comparable facts, in *Orman v. Cullman* the court did not yet question the application of the *Unocal* enhanced scrutiny test to the deal protection provisions in non-*Revlon* transactions. This was to happen later, in *Bear Stearns*<sup>150</sup> and *Ehrenhaus v. Baker*.<sup>151</sup> In addition, courts started to give more deference to the directors’ business judgment in *Revlon* cases.<sup>152</sup>

### B. Toys “R” Us, Inc. Shareholder Litigation

#### 1. Factual Background and Holding

By the end of 2003, Toys “R” Us, Inc., a toys and baby products retail company, was faced with declining profits in its largest division, Global Toys, and a low stock price. The board, consisting mostly of independent directors, explored strategic alternatives to deliver more value to the shareholders. Toys “R” Us sought bids from several potential buyers. The consortium of KKR, Bain Capital, and Vornado proposed to acquire the whole company and topped the next-most-favorable bid.<sup>153</sup> The merger agreement with the KKR Group contained several deal protection provisions. There was a termination fee of

---

147. *Id.* at \*22 (citing Peter Schoenfeld Asset Mgmt. LLC v. Shaw, C.A. No. 20087-NC, 2003 Del. Ch. LEXIS 79 (Del. Ch. July 10, 2003), *aff’d*, 840 A.2d 642 (Del. 2003)).

148. *Id.* at \*22 (citing *Omnicare, Inc. v. NCS Healthcare, Inc.* 818 A.2d 914, 938 (Del. 2003)) (emphasis omitted).

149. See *supra* Part II.A.

150. See *infra* Part III.G.

151. See *infra* Part III.H.

152. See *infra* Parts III.B-E.

153. See *In re Toys “R” Us, Inc. S’holder Litig.*, 877 A.2d 975, 979 (Del. Ch. 2005).

3.75% of equity value, payable for the most part only if Toys “R” Us terminated the merger agreement in order to sign another acquisition proposal within a year, and documented expense reimbursement of up to \$30 million on a so-called “naked no vote.”<sup>154</sup> It included a no-shop provision that permitted the consideration of unsolicited bids.<sup>155</sup> The acquirer also had a matching right for three business days to counter any offer made by a rival bidder.<sup>156</sup>

Two institutional investors who held shares in Toys “R” Us brought a fiduciary duty claim. They sought invalidation of the termination fee and the matching right in the merger agreement claiming that the deal protection measures were draconian and precluded any topping bid.<sup>157</sup>

The Delaware Chancery Court ruled that the board did not breach its fiduciary duty and did not act unreasonably when it agreed to the deal protection measures. The court held that the size of the termination fee, the no-shop provision and the matching right did not act as a serious barrier to any bidder willing to pay materially more than KKR’s offer.<sup>158</sup> It was a *Revlon* transaction (change of control from dispersed to concentrated ownership) in which the directors had to seek the highest value deal that could be secured for stockholders and the heightened standard of reasonableness review applied. However, under the *QVC* “range of reasonableness” test, a decision to sell a company does not prevent the board from offering deal protections to bidders, so long as its decision to do so was reasonably directed to the objective of obtaining the highest price, and not by a “selfish or idiosyncratic desire by the board to tilt the playing field towards a particular bidder for reasons unrelated to the stockholders’ ability to get top dollar.”<sup>159</sup>

## 2. *Revlon* Enhanced Judicial Review Standard

The court applied the *Revlon* standard and refused to give to the protection provisions “the type of close examination of the reasonableness . . . that is contemplated by the *Unocal* . . .

---

154. That is, a shareholder vote to decline the merger agreement that is not followed by the acceptance of an alternative proposal. *Id.* at 997.

155. *Id.* at 996-97.

156. *Id.* at 997.

157. *Id.* at 998.

158. *Id.* at 1018.

159. *Id.* at 1000-01 (citing *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989)).

standard[] . . . .”<sup>160</sup> The plaintiffs used the *Unocal* front-end / back-end argument<sup>161</sup> to challenge the actions of the board, who, by agreeing to the deal protection provisions in the KKR merger agreement, allegedly dissuaded any other bidder from presenting a topping offer. However, the court did not use the *Unocal/Unitrin* analysis and simply stated that the deal protection measures were not draconian.<sup>162</sup>

The court seemed to suggest that the amount of the market check and the strength of deal protections should be comparable. The court found that there was a lengthy pre-signing market check conducted by the target board in good faith and higher-value bidders were unlikely to emerge. “[A]nyone interested had . . . multiple chances to present . . . a serious expression of interest – none had done so.”<sup>163</sup>

Reinforcing *Barkan*, the court stated that the board can even make a tactical choice not to perform an active pre-signing market check:

[The Delaware] Supreme Court has held that the duty to take reasonable steps to secure the highest immediately available price does not invariably require a board to conduct an auction process or even a targeted market canvass in the first instance, emphasizing that there is ‘no single blue-print’ for fulfilling the duty to maximize value.<sup>164</sup>

The court took a position on *Omnicare*. To the court, *Omnicare*’s approach represented an “aberrational departure”<sup>165</sup> from the *QVC* principle. In support of its ruling, the court cited not the “controversial majority opinion,”<sup>166</sup> but the *Omnicare* dissenting opinions.<sup>167</sup>

### C. Topps Company Shareholders Litigation

#### 1. Factual Background and Holding

The Topps Company, Inc., a trading card and candy maker, was exploring strategic options to grow. Michael Eisner, a private equity

---

160. *Id.* at 1016.

161. *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949 (Del. 1985).

162. *See In re Toys “R” Us*, 877 A.2d at 1021.

163. *Id.* at 1018.

164. *Id.* at 1000 (citing *Barkan*, 567 A.2d at 1286).

165. *Id.* at 1016 n.68.

166. *Id.* at 1018 n.70.

167. *Id.* at 1016 n.68.

investor, expressed an interest in making a bid to take the company private, but insisted on the absence of any pre-signing auction.<sup>168</sup> “Eisner . . . envisioned [the] retention of existing management . . . .”<sup>169</sup> A merger agreement was reached. The go-shop provision in the merger agreement gave Topps the right to actively solicit alternative bids for 40 days after signing and the right to accept a Superior Proposal, subject only to Eisner’s receipt of a termination fee and a matching right. The termination fee was bifurcated and amounted to approximately 3% of the transaction value during the go-shop period and 4.6% of the transaction value after the go-shop period.<sup>170</sup> Shortly before the Eisner merger agreement was approved by the Topps’ board, The Upper Deck Company, Topps’ main competitor, expressed a willingness to make a bid. During the go-shop process Upper Deck emerged as the only serious bidder. Although Upper Deck had topped Eisner’s bid, subject to some conditions, the Topps board decided not to continue negotiations with Upper Deck. After the end of the go-shop period, Upper Deck made another unsolicited bid, which Topps refused to recognize as a Superior Proposal.<sup>171</sup> As a result, Eisner did not have to either match Upper Deck’s price or step aside subject to payment of a reverse break-up fee.<sup>172</sup> Topps required Upper Deck to sign a standstill agreement prohibiting Upper Deck from proceeding with a tender offer without permission from the Topps board.<sup>173</sup>

Upper Deck and some Topps shareholders moved for a preliminary injunction against the procession of the shareholder vote on the Eisner merger. The plaintiffs argued that, under *Revlon* principles, the board should not deny the shareholders the chance to make an uncoerced decision for themselves and that the deal protection measures in the Eisner merger agreement precluded any effective post-signing market check.<sup>174</sup>

The Delaware Chancery Court applied the *Revlon* standard of

---

168. See *In re Topps Co. S’holders Litig.*, 926 A.2d 58, 61 (Del. Ch. 2007).

169. *Id.*

170. *Id.* at 65.

171. *Id.* at 62.

172. *Id.*

173. *Id.* at 66.

174. The motion was ultimately granted on disclosure grounds, *In re Topps Co. S’holders Litig.*, 926 A.2d 58, 63, 93 (Del. Ch. 2007), which are different from the issues under consideration in this Essay. Here I only focus on deal protections and related issues.

review. It held that the deal protections as a whole “seem to have left reasonable room for an effective post-signing market check,”<sup>175</sup> although the termination fee of 4.3%<sup>176</sup> of the total deal value was “a bit high in percentage terms.”<sup>177</sup> The court took into consideration “the potential utility of having the proverbial bird in hand.”<sup>178</sup> However, Upper Deck was released from the standstill agreement on the grounds that the Topps board acted with self-interest when it did not allow Upper Deck to proceed with a higher-priced offer.<sup>179</sup>

## 2. Revlon Reasonableness Tainted by the Board’s Self-Interest

The court found the deal protections in the Eisner merger agreement (a go-shop paired with a termination fee and a matching right) to be reasonable under *Revlon*. “For 40 days, the Topps board could shop like Paris Hilton.”<sup>180</sup> A go-shop provision instead of a pre-signing market check was held to be reasonable. The court indicated that go-shops may be useful in inducing other bids because the existence of a “credible [and] committed” initial acquirer may act as a form of “sucker’s insurance” for others to take the leap and submit a bid.<sup>181</sup>

A go-shop provision protects the deal indirectly. On the one hand, go-shops are usually paired with such deal protections as termination fees and matching rights. On the other hand a go-shop provision eliminates, from the target board’s perspective, the requirement to have a pre-signing market check. However, go-shops as a post-signing market check mechanism are not a full alternative to a pre-signing market check. Critics argue that third party bidders are less likely to emerge post-signing and go-shops are merely “window dressing.”<sup>182</sup>

---

175. *Id.* at 86.

176. *Id.*

177. *Id.*

178. *Id.* at 87.

179. *Id.* at 92.

180. *Id.* at 86.

181. *Id.* at 87.

182. Mark A. Morton & Roxanne L. Houtman, *Go-Shops: Market Check Magic or Mirage?*, ATT’Y ADVERTISING, Feb. 2008, available at <http://www.potteranderson.com/assets/attachments/Go-ShopsRevFeb2008.pdf>. Cf. Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops: The Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525, 572 (2008) (noting that go-shops are “[n]ot [s]o [d]ifferent from [n]ot [s]hopping [a]fter [a]ll”).

For other potential bidders a go-shop provision presents a big problem as they have to start at a huge disadvantage. Commentators also point out that the limited go-shop period can affect a third-party's ability to come up with a competitive superior proposal, particularly because of its inability to arrange financing.<sup>183</sup> Having sanctioned the development from a pre-signing market check to a go-shop, courts have sanctioned stronger deal protections and weaker market checks.

The standstill agreement with Upper Deck in effect locked up the Eisner transaction, since Upper Deck was the only serious alternative bidder and it could not pursue the acquisition. However, the provision in the standstill agreement, which allowed Topps to release Upper Deck from the standstill if the board believed its fiduciary duties so required, worked as a fiduciary-out. If there were no favoritism towards Eisner by the Topps management with entrenchment motivations, the court would have probably endorsed the standstill agreement.

Arguably, the proverbial "bird in hand" is present in any acquisition, but the court in *Topps* granted to the proverbial bird greater credence than the *Omnicare* court did.

#### D. Lear Corporation Shareholder Litigation

##### 1. Factual Background and Holding

In 2005, Lear Corporation, an automotive parts supplier, was in the middle of a restructuring to keep itself healthy in a depressed automotive industry when billionaire Carl Icahn came along and started investing in the company with a view to becoming its largest investor. Icahn later offered to buy the whole company while retaining the Lear management, but insisted on the absence of a pre-signing auction.<sup>184</sup> The board agreed, taking into account that an auction could disrupt the company's business or that it might cause Icahn to withdraw his offer.<sup>185</sup> The negotiations for Lear were effectively led by its CEO, Robert Rossiter. The merger agreement contained a moderate termination fee payable if Lear accepted a superior proposal from another bidder and matching rights for Icahn. In exchange, Lear got a go-shop for 45 days and the right to accept an unsolicited superior third-party bid after the go-shop

---

183. See Thomas J. Dougherty, *Securities Litigation: Planning and Strategies: Takeovers*, SM086 ALI-ABA 327, 330 (2007).

184. *In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 97 (Del. Ch. 2007).

185. *Id.* at 104.

period ended.<sup>186</sup> The board also obtained Icahn's agreement to vote his shares for any bid superior to his own that was accepted by the board and that Icahn did not match.<sup>187</sup> Although financial advisors "aggressively"<sup>188</sup> shopped the company, no topping bid was made.<sup>189</sup>

Some Lear shareholders moved to enjoin the shareholder vote on the merger arguing that the Lear board had breached its fiduciary duties by failing to secure the highest price reasonably available.

The Delaware Chancery Court rejected plaintiffs' claims.<sup>190</sup> It pointed out the overall reasonableness of the board's efforts to secure the highest possible value. The court held that "deal protection measures did not present an unreasonable barrier to any second-arriving bidder."<sup>191</sup>

## 2. Limiting Topps

In *Lear*, a tainted CEO negotiated the merger agreement. Icahn promised to retain the management, which gave them the possibility of becoming fully vested in their retirement plans within two years. Rossiter had options which he could net quickly and was granted even more options as a result of the merger.<sup>192</sup> A lower merger price would likely have set a lower strike price for the options Rossiter received post-merger. The court freed Rossiter from "fiduciary quandary."<sup>193</sup> It found that Rossiter did not act "in any way inappropriately,"<sup>194</sup> because the Icahn merger would allow all stockholders to sell at a premium.

The court did not want to "elevate a persnickety sense of Ivory Soap purity over business logic."<sup>195</sup> It recognized that those suffering from conflicts are capable of putting them aside. According to the court, this is the reality of American business history; managers "exploited the opportunity to work on both sides of a deal."<sup>196</sup> This is different from

---

186. *Id.* at 108.

187. *Id.* at 121.

188. *Id.* at 97.

189. *Id.*

190. The motion was partly granted on disclosure grounds. Here I only focus on deal protections and related issues. *Id.* at 97.

191. *Id.* at 97-98.

192. *Id.* at 109.

193. *Id.* at 116.

194. *Id.* at 114.

195. *Id.* at 116.

196. *Id.* at 117.

the reasoning in *Topps*, where the court was strictly opposed to any entrenchment motivations of the board and struck down the standstill agreement between *Topps* and *Upper Deck* based on these grounds.<sup>197</sup>

A pre-signing auction presented the risk of losing Icahn's bid and Lear consented to a post-signing market check. The court found the deal protections reasonable:

The go-shop period was truncated and left a bidder hard-pressed to do adequate due diligence, present a topping bid with a full-blown draft merger agreement, have the Lear board make the required decision to declare the new bid a superior offer, wait Icahn's ten-day period to match, and then have the Lear board accept that bid, terminate its agreement with Icahn, and "substantially concurrently" enter into a merger agreement with it.<sup>198</sup>

All of these events had to occur within the 45 day window, but a ravenous bidder could do this.<sup>199</sup> The court found that the 3.52% termination fee was reasonable because it was not of a level that would deter a serious bid.<sup>200</sup> The court treated Icahn's matching rights similarly, stating that they were hardly novel and had been upheld even when coupled with termination fees.<sup>201</sup>

In *Lear*, the court helped the board to find an excuse for not getting the best value for the shareholders. It mentioned the appraisal rights for those shareholders who did not think the price was high enough.<sup>202</sup>

The court used emergency reasoning to justify deal protections: "Icahn was tying up \$1.4 billion in capital to make a bid for a corporation in a troubled industry . . . ." <sup>203</sup> Exigent circumstances, as explained later, were cited as an additional reason to depart from *Omnicare* in the J.P. Morgan-Bear Stearns and Wells Fargo-Wachovia deals.<sup>204</sup>

*Lear* limited *Topps* back to the *Toys* "R" Us standard and even went beyond. If the shareholders thought the company was worth more,

---

197. Cf. *supra* Part III.C.

198. *In re Lear*, 926 A.2d at 119.

199. *Id.* at 119-20.

200. *Id.* at 120.

201. *Id.* at 120 n.21.

202. *Id.* at 122.

203. *Id.* at 120.

204. See *infra* Parts III.G-H.



they could seek appraisal instead of accusing the board of non-compliance with its *Revlon* duties. The court in *Lear* showed great deference to the board's business logic and business judgment. "Reasonableness, not perfection, measured in business terms relevant to value creation, rather than by what creates the most sterile smell, is the metric."<sup>205</sup>

E. *Optima International of Miami v. WCI Steel*

1. Factual Background and Holding

In the end of 2007, WCI Steel, Inc. was a troubled steel company owned by 28 stockholders, two of which controlled a majority of the outstanding voting power. Severe liquidity problems had put WCI under great pressure either to sell the company or to face a bankruptcy liquidation.<sup>206</sup> WCI was operating under a collective bargaining agreement, which gave the United Steelworkers Union a veto right over any change-of-control transaction.<sup>207</sup> By April 2008, two potential bidders emerged: OAO Severstal and Optima International of Miami, Inc.<sup>208</sup> The Union decided to support Severstal and Severstal submitted a bid in the amount of \$101 million. In the bidding war with Optima, Severstal raised its bid to \$140 million, but conditioned it on the board acting immediately to approve the deal and to obtain stockholder authorization. The board accepted the Severstal offer, a merger agreement was signed and within a few minutes two majority stockholders signed written consents thereby providing the requisite stockholder approval of the merger.<sup>209</sup> Optima had a standstill agreement with WCI, from which WCI refused to release it.<sup>210</sup>

Optima sought to enjoin the Severstal merger, arguing that the WCI board had violated its duties under *Omnicare* by contracting away its fiduciary-out by seeking and obtaining stockholder approval immediately rather than seeking to keep the bidding process alive. Optima argued, relying on *Topps*, that the WCI refusal to release it from the

---

205. See *In re Lear*, 926 A.2d at 118.

206. Optima Transcript, *supra* note 2, at 119-20.

207. *Id.* at 118-19.

208. *Id.* at 120-21.

209. *Id.* at 133-37.

210. *Id.* at 128.

standstill agreement was a breach of fiduciary duty.<sup>211</sup>

The Delaware Chancery Court refused to enjoin the merger. The court held that the board's action in obtaining nearly immediate stockholder approval did not impermissibly lock-up the deal. "The stockholder vote, although quickly taken, was simply the next step in the transaction as contemplated by the statute. Nothing in the DGCL requires any particular period of time between a board's authorization of a merger agreement and the necessary stockholder vote."<sup>212</sup> The court held that the board did not breach its *Revlon* duties in agreeing to the Severstal merger rather than continuing to negotiate with Optima, which actually had a higher, though more conditional, bid on the table. "The board . . . exercised a very thorough judgment . . ."<sup>213</sup> Regarding the standstill agreement with Optima, the court held that the board had a reasonable basis not to allow a higher bidder to directly approach the stockholders: it made a business decision that waiving the standstill agreement would have merely threatened litigation with the Union.<sup>214</sup>

## 2. *Revlon* Scrutiny Limited to the Board's Business Judgment

*Optima v. WCI* established that, notwithstanding *Omnicare*, the board and the majority stockholders were allowed to act definitively to sign up and consummate a deal that was, in the board's judgment, in the best interests of the stockholders. The court upheld board action approving a transaction where "a clear majority [of the stockholders] were in favor of the board acting in such a way as to be sure not to lose the Severstal bid."<sup>215</sup> This position directly refers to the approach advocated by the dissenting judges in *Omnicare*.<sup>216</sup>

The shareholder approval of the Severstal merger was secured via written consents of the majority shareholders. This mechanism in fact equals to the cumulative effect of the *Omnicare*'s voting agreements paired with the "force-the-vote" provision in the merger agreement. The court, however, held that that written consents are "not like the lockup in *Omnicare*."<sup>217</sup>

---

211. *Id.*

212. *Id.* at 127.

213. *Id.* at 138.

214. *Id.* at 128-29.

215. *Id.* at 133.

216. *Cf. supra* Part II.C.

217. *Optima* Transcript, *supra* note 2, at 127.

The court found that the board weighed all the risks associated with the different offers then available and concluded that it was appropriate to approve the Severstal merger. The board had decided that it was better for stockholders “to take Severstal’s lower-but-more-certain bid than Optima’s higher-but-more-risky bid.”<sup>218</sup> The court declared: “I don’t substitute my judgment for that of the board or my business judgment for the board’s judgment. My job is to look at what the directors did and determine whether the actions they took are within a range of reasonableness.”<sup>219</sup> This case clearly evidences more judicial deference to the board’s business judgment, even with regard to the Optima standstill agreement, which WCI refused to lift.

The court indicated that it was sensitive to the WCI liquidity problems and that it was unclear whether Optima would be able to consummate the transaction as a result of the Union’s opposition. These external pressures on the board also supported greater court deference to the board business judgment.

#### F. Ryan v. Lyondell

This deal – a cash-for-stock merger between Basell AF, a privately held Luxemburg company, and Lyondell Chemical Company – led to a long litigation, in which both the Delaware Chancery Court and the Delaware Supreme Court had a chance to examine the merits.

#### 1. Factual Background and Holding

Lyondell was approached by Basell with an all-cash merger proposal. Lyondell’s Chairman and CEO was able to raise Basell’s offer from the initial \$40 to \$48 per share.<sup>220</sup> Basell dropped a financing contingency in the merger agreement, but required that Lyondell sign a merger agreement within one week.<sup>221</sup> Lyondell’s board considered Basell’s offer at four special meetings, which lasted for a total of seven hours, and consented to the merger. The merger agreement contained a no-shop provision, subject to a fiduciary-out, matching rights for Basell and a \$385 million termination fee; a go-shop provision was requested

---

218. *Id.*

219. *Id.* at 138.

220. Ryan v. Lyondell Chem. Co., C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105, at \*22 (Del. Ch. July 29, 2008).

221. *Id.* at \*\*22-23.

by the Lyondell board, but was rejected by Basell. Lyondell's board pulled the poison pill with respect to the Basell proposal.<sup>222</sup>

Some shareholders challenged the merger and, in particular, used the *Unocal/Unitrin* test to contest the deal protections. They argued that the deal protections, acting in concert, precluded other bids for the company, which, in turn, coerced Lyondell shareholders to accept the Basell proposal. In addition, the plaintiffs argued that the directors, under *Revlon*, acted unreasonably by granting considerable deal protections to Basell, which rendered the Basell merger a *fait accompli*. It was claimed that the directors failed to obtain the best available price in selling the company and therefore breached their duty of loyalty by failing to act in good faith.

The limits of a summary judgment motion did not allow the Delaware Chancery Court to decide the ultimate issue of the reasonableness of deal protection provisions in the merger agreement, due to unresolved questions of fact,<sup>223</sup> and the Chancery Court denied the summary judgment motion as to the deal protection invalidity claims. However, the court made some observations that are important to this Essay. It analyzed the merger agreement and the deal protections under both the *Revlon* and *Unocal* standards. The court announced that after trial it might be satisfied that the board undertook to discharge its *Revlon* duties in good faith under the circumstances, in this case the board's decision to accede to this particular mix of deal protections would be deemed reasonable.<sup>224</sup> The court stated that, under the *Orman/Williams* coerciveness principle, the deal protections and other provisions in the Basell merger agreement did not have the effect of causing the shareholders to vote in favor of the Basell transaction for reasons other than its merits.<sup>225</sup>

The Delaware Supreme Court reversed. It held that the directors were disinterested and independent, generally aware of the company's value and its prospects and had reason to believe that no other bidders would emerge, given the price Basell had offered and the limited universe of companies that might be interested in acquiring Lyondell's unique assets. The directors negotiated the price up and considered the offer under the time constraints imposed by the buyer, with the

---

222. *Id.* at \*31.

223. *Id.* at \*83.

224. *Id.*

225. *Id.* at \*\*76-77.

assistance of financial and legal advisors. “There is no evidence that the directors knowingly ignored their responsibilities, thereby breaching their duty of loyalty. Accordingly, the directors were entitled to the entry of summary judgment.”<sup>226</sup>

## 2. Lyondell Total Deference Standard

In *Ryan v. Lyondell* the Delaware Chancery Court analyzed the deal protection devices in a Revlon transaction under both the *Unocal/Unitrin* and *Revlon* standards. The court stated:

One might read *Omnicare* to suggest that deal protection measures must withstand the enhanced judicial scrutiny test prescribed by *Unocal*. The better reading of *Omnicare*, however, is that the Delaware Supreme Court reconfirmed that enhanced judicial scrutiny, regardless of the particular analytical framework, is the appropriate test for this Court to apply when reviewing a board’s decision to grant deal protections. *Unocal* is but one formulation of enhanced scrutiny that might be applied; it is not, however, the only test, nor is it necessarily appropriate in all circumstances. Thus, *Omnicare* did not mark an analytical sea change; instead, it is consistent with numerous cases in which this Court has carefully scrutinized a board’s decision to grant deal protections before according it the deference normally given to directors’ business decisions.<sup>227</sup>

The Delaware Chancery Court required for deal protections just some enhanced judicial scrutiny, regardless of a particular formal standard. This rejection of the traditional post-*Omnicare* dichotomy: *Unocal* analysis for non-*Revlon* transactions vs. *QVC* “range of reasonableness” analysis for *Revlon* transactions – supports the total deference to the directors’ business judgment. When reasonableness is “measured in business terms relevant to value creation,”<sup>228</sup> it becomes very similar to the “laxer standard of rationality review applicable under the business judgment rule.”<sup>229</sup>

Under previous decisions (*Toys “R” Us*, *Topps*, *Lear*), an active market check, either pre-signing or post-signing, performed through the

---

226. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 237 (Del. 2009).

227. *Ryan v. Lyondell Chem. Co.*, C.A. No. 3176-VCN, 2008 Del. Ch. LEXIS 105, at \*75 (Del. Ch. July 29, 2008).

228. *In re Lear Corp. S’holder Litig.*, 926 A.2d 94, 118 (Del. Ch. 2007).

229. *In re Toys “R” Us, Inc. S’holder Litig.*, 877 A.2d 975, 1000 (Del. Ch. 2005).

solicitation of potential bidders, was required for the board to be found to have acted reasonably in undertaking a sale of the company.<sup>230</sup> The Delaware Supreme Court decision in *Ryan v. Lyondell* eliminated the (active) market check requirement altogether – neither a pre-signing nor a post-signing active market check is now required. There is only one *Revlon* duty – to get the best deal for the shareholders at a sale of the company. “No court can tell directors exactly how to accomplish that goal, because they will be facing a unique combination of circumstances, many of which will be outside their control.”<sup>231</sup> It is wrong for a court to suggest to the board which steps to take to satisfy its *Revlon* duties – by engaging actively in the sale process, by conducting an auction, by conducting a market check or by demonstrating “an impeccable knowledge of the market.”<sup>232</sup>

### G. Bear Stearns Shareholder Litigation<sup>233</sup>

#### 1. Factual Background and Holding

In March 2008, The Bear Stearns Companies Inc., a leading investment banking firm, faced first a liquidity crisis and later a bankruptcy risk. The Federal Reserve and J.P. Morgan Chase & Co., a global financial services firm, with the support of the U.S. Department of the Treasury, agreed to provide emergency funding to Bear Stearns and on March 24, 2008 a stock-for-stock merger between J.P. Morgan and Bear Stearns with an implied value of \$10 per share and a related share exchange agreement was announced.<sup>234</sup> The merger agreement contained an asset option (an option to purchase Bear Stearns’ corporate headquarters in New York for \$1.1 billion, exercisable within 120 days after Bear Stearns shareholders had voted down the merger agreement), and a no-shop clause, subject to a fiduciary-out.<sup>235</sup> Under the terms of

---

230. See *supra* Parts III.B-D.

231. *Lyondell Chem. Co.*, 970 A.2d at 242.

232. *Id.* at 243 (citing *Ryan*, 2008 Del. Ch. LEXIS 105, at \*19).

233. Both J.P. Morgan’s government-supported acquisition of Bear Stearns and Wells Fargo’s acquisition of Wachovia (see *infra* Part III.H) were struck amidst financial turmoil. The emergency argument has been increasingly used by the courts to justify their business judgment deference when reviewing deal protection devices in non-*Revlon* transactions.

234. *In re Bear Stearns Litig.*, 870 N.Y.S.2d 709, 723 (N.Y. Sup. Ct. 2008).

235. *Id.* at 722-23.

the share exchange agreement, J.P. Morgan was to purchase 39.5% of Bear Stearns' common stock for \$2 per share.<sup>236</sup>

Bear Stearns shareholders challenged the J.P. Morgan merger agreement alleging that the proposed merger was at an inadequate price and was approved by the Bear Stearns directors in breach of their fiduciary duties. The plaintiffs argued that the board impermissibly allowed the incorporation of a combination of onerous and coercive deal protection devices into the merger agreement, which disenfranchised the shareholders.<sup>237</sup>

The Supreme Court of New York<sup>238</sup> decided the case applying Delaware law. It held that the *Unocal*, *Revlon* and *Blasius*<sup>239</sup> enhanced scrutiny did not apply and that deal protection measures were valid under the business judgment rule.<sup>240</sup>

## 2. Bear Stearns Standard: Business Judgment Rule for Deal Protection Devices in a Non-Revlon Transaction

The J.P. Morgan/Bear Stearns deal's unprecedented deal protection measures – especially the 39.5% share exchange agreement – would probably be invalid under *Unocal/Unitrin*, as they rendered Bear Stearns shareholders' approval rights entirely illusory.<sup>241</sup> The asset option was

236. *Id.* at 732.

237. *Id.* at 730.

238. The Delaware Chancery Court abstained from ruling in the shareholder litigation, taking advantage of a pending New York action to stay the Delaware lawsuit. *See In re Bear Stearns Cos., Inc., In re S'holder Litig.* Consolidated C.A. No. 3643-VCP, 2008 Del. Ch. LEXIS 46, at \*29 (Del. Ch. Apr. 9, 2008). Kahan and Rock called this move "strategic use of comity." *See generally* Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713 (2009).

239. The court limited the application of *Blasius* only to director election contests. *See In re Bear Stearns Cos. S'holder Litig.*, 2008 Del. Ch. LEXIS 46, at \*\*20-21. *Cf. supra* note 52 and accompanying text.

240. *In re Bear Stearns Litig.*, 870 N.Y.S.2d 709, 730 (N.Y. Sup. Ct. 2008).

241. *Cf. Kahan & Rock, supra* note 238, at 713, 721-38. *See also* Mark J. Roe, *Delaware and Washington as Corporate Dealmakers*, 34 DEL. J. CORP. L. 1, 14 (2009) ("That high a level of deal protection would not ordinarily fly under Delaware law . . ."). J.P. Morgan purchased 10% of the outstanding shares on the open market; therefore, it held altogether 49.5% of Bear Stearns shares. *See In re Bear Stearns Litig.*, 870 N.Y.S.2d at 724. Although this missed by 0.5% the formal majority threshold, J.P. Morgan effectively controlled the shareholder vote. *Cf. Kahan & Rock*, at 729 ("Any notion that the deal was not locked up by March 24—because J.P. Morgan's ownership

primarily directed at shielding the merger from the shareholders, which would vote down the deal and take their chances at the company's property if Bear Stearns were liquidated. This was a rare case of a crown jewel lockup, after these were invalidated in *Revlon* and in *Mills Acquisition v. Macmillan*.<sup>242</sup>

The court held that neither enhanced scrutiny standard was applicable to deal protection devices. There was no evidence that the board acted out of self-interest or in bad faith. "The board's efforts to preserve some shareholder value while averting the uncertainty of a bankruptcy – an event with potentially cataclysmic consequences for the broader economy as well as for the shareholders – would survive scrutiny even if some enhanced standard of review under Delaware law did apply."<sup>243</sup> Under the *Revlon* test, Bear Stearns directors acted reasonably because they were "sophisticated and knowledgeable about the industry and strategic alternatives available to the company; were involved in the negotiation process and bargained hard; relied on expert advice; and received a fairness opinion from a financial advisor."<sup>244</sup> Under the *Unocal* test, the liquidity crisis threatened Bear Stearns with extinction and the directors' response was proportionate to the threat as Bear Stearns' very survival "depended on consummating a transaction with a financially sound partner."<sup>245</sup> However, "[h]eightedened scrutiny of the merger protection provisions is simply not warranted in the instant case."<sup>246</sup> *Revlon* is not applicable, as "JPMorgan . . . did not become a majority shareholder. . . . [and] the public shareholders retained ultimate control."<sup>247</sup> "*Unocal* is inapplicable in a case where the board initiates the transaction in the absence of . . ." a hostile third party threat to corporate control.<sup>248</sup> "Inasmuch as, none of the enhanced standards apply, the deal protection measures are reviewable only under the business judgment rule."<sup>249</sup>

---

was below 50% and there was a hypothetical possibility that the shareholders would not approve the deal—flies in the face of both reality as well as the careful, contextual analysis performed by the Delaware Supreme Court in *Unitrin*.”).

242. See *supra* note 30 and accompanying text.

243. *In re Bear Stearns*, 870 N.Y.S.2d at 718.

244. *Id.* at 732.

245. *Id.* at 731.

246. *Id.* at 734.

247. *Id.* at 733-34.

248. *Id.* at 733.

249. *Id.* at 734.



The court excluded application of the *Unocal* test to deal protection devices. The court expressly stated that *Unocal* was inapplicable to deal protection devices in the absence of a hostile third party threat.<sup>250</sup> Therefore, the court altogether rejected *Omnicare* with its application of the *Unocal* test to deal protection devices. To support its holding that the deal protection measures are reviewable under the business judgment rule, the court referred to the pre-*Omnicare* cases: *IXC* and *Bartlett*,<sup>251</sup> as if no *Omnicare* ruling existed.

The application of the business judgment rule to the deal protections was warranted mainly by the “very real emergency which the company faced . . . .”<sup>252</sup> “The financial catastrophe confronting Bear Stearns, and the economy generally, justified the inclusion of the various merger protection provisions intended to increase the certainty of the consummation of the transaction with J.P. Morgan.”<sup>253</sup> Due to an emergency situation, the court did not insist on any market check and endorsed strong deal protections.

H. Ehrenhaus v. Baker

1. Factual Background and Holding

During the financial storm of 2008, on September 25, 2008, the “death knell . . . began sounding”<sup>254</sup> for Wachovia Corporation, large financial services company. Facing significant downward market pressure on the company’s share price following these events, the Wachovia senior management began vetting merger suitors.<sup>255</sup> Wells Fargo & Company and Citigroup, Inc. quickly emerged as potential merger partners. On September 29, 2008, Citigroup and Wachovia signed (what Wachovia characterized as a non-binding) agreement to acquire Wachovia’s banking subsidiaries.<sup>256</sup> On October 2, 2008, Wells Fargo tendered a competing merger proposal to acquire all of

---

250. *Id.* at 733.

251. *See supra* note 65.

252. *In re Bear Stearns*, 870 N.Y.S.2d at 730.

253. *Id.* at 735.

254. *Ehrenhaus v. Baker*, Civil Action No. 08 CVS 22632, 2008 NCBC LEXIS 20, at \*10 (N.C. Super. Ct. Nov. 3, 2008).

255. *Id.* at \*11.

256. *Ehrenhaus v. Baker*, Civil Action No. 08 CVS 22632, 2008 NCBC LEXIS 21, at \*49. (N.C. Super. Ct. Dec. 5, 2008).

Wachovia's assets. Next day, after being advised that the Federal Deposit Insurance Corporation was prepared to place Wachovia into receivership if a merger did not materialize with either Citigroup or Wells Fargo, the Wachovia board approved the Wells Fargo proposal.<sup>257</sup> The merger agreement contemplated a stock-for-stock transaction. The merger agreement did not allow the Wachovia board to withdraw from the merger should a third party offer a higher bid; instead, the board was required to put the matter to a shareholder vote. The merger agreement also prohibited Wachovia from soliciting alternative acquisition proposals.<sup>258</sup> In conjunction with the merger, a separate share exchange agreement granted Wells Fargo 39.9% of Wachovia aggregated voting rights (the original proposal required a transfer of more than 50% of the total voting power, but the Wachovia board negotiated this down to 39.9%).<sup>259</sup> Wachovia was prohibited from redeeming those shares for 18 months following a vote on the merger agreement, even if the merger was not consummated.<sup>260</sup>

The shareholders of Wachovia claimed that the board of directors breached its fiduciary duties to the company's shareholders when they approved the Wells Fargo merger. The plaintiffs claimed that the transfer of almost 40% of Wachovia's aggregate voting rights to Wells Fargo pursuant to the share exchange was unduly coercive, effectively disenfranchised public shareholders and precluded any competing bid for the company.<sup>261</sup>

The North Carolina Superior Court applied North Carolina law and "look[ed] to Delaware for guidance on questions of corporate governance because of the special expertise and body of case law developed in the Delaware Chancery Court and the Delaware Supreme Court."<sup>262</sup> The court held that, as long as the decision to include the deal protection measures in the merger agreement was informed, was made in good faith and with an honest belief that the action was in the best interests of the company and its shareholders, the board's business judgment<sup>263</sup> would not be disturbed by the courts absent proof by clear

---

257. *Id.* at \*\*69-70.

258. *Id.* at \*55.

259. *Id.* at \*61 n.14.

260. *Id.* at \*2.

261. *Id.* at \*81.

262. *Id.* at \*90 n.19.

263. The court referred to the opinion in *Hammonds v. Lumbee River Elec. Membership Corp.*, 631 S.E.2d 1, 20-21 (N.C. Ct. App. 2006), for formulation of the

and convincing evidence of interference with shareholder voting rights or statutory duties.<sup>264</sup>

If [a shareholder] fails to prove a breach of duty, the action of the directors [of a corporation] is entitled to a strong presumption of reasonableness and validity, including noncoercion, and the court should not intervene unless the shareholder can rebut that presumption by clear and convincing evidence that the deal protection provisions were actionably coercive, or that the deal protection provisions prevented the directors from performing their statutory duties.<sup>265</sup>

Only with regard to the 18 months limitation on the board's ability to redeem the shares that gave Wells Fargo 39.9% of Wachovia's total voting power, the court concluded that this provision prevented the board from fulfilling its fiduciary duties and was invalid.<sup>266</sup>

## 2. Wachovia Standard: Business Judgment Rule for Deal Protection Devices in a Non-Revlon Transaction

Under *Omnicare*, the deal protection devices in a non-*Revlon* transaction should be subject to the *Unocal* test. However, absent coerciveness, the court in this case deferred to the board's business judgment.

The Wells Fargo merger agreement contained strong deal protection provisions. More than 40%<sup>267</sup> voting power in Wells Fargo, although not representing an absolute majority of the votes required for approval of the merger agreement, effectively locked up the shareholder vote. Wells Fargo's shareholder vote lockup in conjunction with the "force-the-vote" provision in the merger agreement made an alternative deal "mathematically impossible," in *Omnicare* terms. The court held, however, that "a majority of Wachovia shareholders (owning nearly 60% of all Wachovia shares) 'may still freely vote for or against the merger, based on their own perceived best interests, and ultimately

---

business judgment rule under North Carolina law.

264. *Ehrenhaus*, 2008 NCBC LEXIS 21, at \*100 (citing *First Union Corp. v. Suntrust Banks, Inc.*, 2001 NCBC 9A, ¶ 72 (N.C. Super. Ct. 2001)).

265. *Id.* at \*101 (citing *First Union*, 2001 NCBC 9A, ¶ 70).

266. *Id.* at \*\*159-62.

267. Wells Fargo also held 32,883,669 shares of Wachovia, which, together with those shares obtained under the shares exchange agreement, amounted to 40.8% of the Wachovia's total voting power. *See Ehrenhaus*, 2008 NCBC LEXIS 21, at \*78 n.18.

defeat the merger, if they desire”<sup>268</sup> and that the share exchange agreement did not preclude other bidders coming forward.<sup>269</sup>

The court pointed out that Wachovia board was confronted with extraordinary circumstances:<sup>270</sup> the case was unique due to the “presence of the 800-pound gorilla in the Wachovia board room, in the form of the U.S. government’s pervasive regulatory oversight over bank holding companies.”<sup>271</sup> The threat of government intervention, in the form of a forced liquidation of the company’s banking assets, weighed heavily on the board as it considered the Wells Fargo merger agreement. All these factors justified business judgment deference: “directors often make important decisions under fluid and uncertain circumstances and that a court must be loathe to review such judgments on the basis of *ex post* judicial hindsight.”<sup>272</sup>

### I. Synthesizing Post-Omnicare Cases on Deal Protection Devices

*Omnicare* established the following dichotomy with regard to the standard of review of deal protection provisions in a merger agreement: in a *Revlon*-transaction, the *QVC* “range of reasonableness” test is applicable, whereas in a non-*Revlon* transaction the *Unocal/Unitrin* two-step analysis applies. This dichotomy has been effectively changing through the post-*Omnicare* jurisprudence to the directors’ business judgment deference for deal protections in both *Revlon* and non-*Revlon* transactions.

When no change of control is involved in a corporate acquisition transaction, a court will review the deal protection devices under the traditional business judgment rule (*Bear Stearns and Ehrenhaus v. Baker*). Unless the procedural presumption of the business judgment rule is rebutted, a court will not substitute its judgment for that of the board if the board’s decision can be attributed to any rational business

---

268. *Ehrenhaus v. Baker*, Civil Action No. 08 CVS 22632, 2008 NCBC LEXIS 21, at \*142 (N.C. Super. Ct. Dec. 5, 2008) (citing *In re IXC Communications, Inc. S’holders Litig.*, Consolidated C.A. No. 17324, 1999 Del. Ch. LEXIS 210, at \*23 (Del. Ch. Oct. 27, 1999)).

269. *Id.*

270. The court referred to the *Bear Stearns* opinion of its New York colleague, in which the court stated that “[t]he financial catastrophe confronting Bear Stearns, and the economy generally, justified the inclusion of the various merger protection provisions . . .” *See id.* at \*121.

271. *Id.* at \*122.

272. *Id.* at \*117.

purpose.<sup>273</sup> In *Bear Stearns* the court expressly stated that *Unocal* analysis is not applicable to deal protections, this test is only for hostile takeover battles. Only in *Orman v. Cullman* the court applied to deal protection devices the *Unocal* test, although coerciveness was denied. Written consents given by the majority shareholders have been explicitly endorsed in *Orman v. Cullman*.

In determining whether the deal protections are within a “range of reasonableness” in a *Revlon* transaction, courts usually weigh such considerations as how early in the negotiation process the deal protections were given and the value-enhancing nature of their specific terms. “Standard deal protection that the board grants after completing . . . [some form of a market check will] survive heightened review under *Revlon/QVC*, while a similar option[s] granted very early in the process are more susceptible to an ex post attack”<sup>274</sup> (*Toys “R” Us, Topps, Lear*). In practice, post-signing market checks, most notably go-shop provisions, have been developed in response to bidders who insisted on absence of any pre-signing market check. Courts have endorsed post-signing market checks, although they are weaker and effectively allow for utilizing stronger deal protections (*Topps, Lear*). As a further step, courts allow the boards to skip any active market check if they can demonstrate thorough knowledge of the market (*Ryan v. Lyondell*). Since *Toys “R” Us*, absent some entrenchment motivation, the courts, applying the *Revlon* test, have been giving to target board actions more business logic deference. Later they even recognized that directors can put aside conflicts arising from working on both sides of a deal (*Lear*). The board can refuse to lift a standstill agreement with the unwanted bidder and by doing this preclude such bidder from directly approaching the shareholders if it has reasonable grounds for doing so (*Optima v. WCI*). Courts even helped the board to find an excuse for non-compliance with its *Revlon* duties: they mentioned appraisal rights (*Lear*).

In emergency situations, when the target board faces an extreme liquidity crisis as a result of “unprecedented financial tsunami”<sup>275</sup> the deference to directors’ business judgment is even stronger (*Bear Stearns, Ehrenhaus v. Baker*). This emergency exception applies not

---

273. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

274. *Cf. ALLEN ET AL.*, *supra* note 18, at 583 (emphasis added).

275. *Ehrenhaus v. Baker*, Civil Action No. 08 CVS 22632, 2008 NCBC LEXIS 21, at \*131 (N.C. Super. Ct. Dec. 5, 2008) (emphasis omitted).

only to government-supported deals. It can effectively limit the *Revlon* enhanced review to the business judgment deference in purely private deals (*Lear*, *Optima v. WCI*).

#### IV. CONCLUSION

Subsequent case law shows that over time courts have been narrowing the holding in *Omnicare*. They have been expanding the statement made in *Omnicare* that “[a]ny board has authority to give the proponent of a recommended merger agreement reasonable structural and economic defenses, incentives, and fair compensation if the transaction is not completed.”<sup>276</sup> In addition, in the recent government-supported deals the limits of deal protection devices have been stretched and the courts in New York and North Carolina have followed the tendency which seems to have been established for private deals in Delaware. It remains to be seen how soon *Omnicare* will be formally overturned.<sup>277</sup>

---

276. *Omnicare*, 818 A.2d at 938.

277. *Cf.* Subramanian, *supra* note 124, at 758 n.118 (“[T]he change in the membership of the Delaware Supreme Court since the *Omnicare* decision suggests that an explicit reversal is no implausible.”).

## *Notes & Observations*